United States Court of Appeals for the Second Circuit



APPELLEE'S BRIEF

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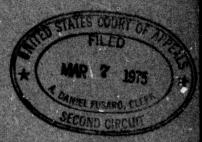
74-2588

To be argued by John J. Levin

United States Court of Appeals

For the Second Circuit

In re: SEEBURG-CCMMONWEALTH UNITED LATIGATION DOCKET No. M-19-95



BERRY PETROLEUM COMPANY, an Arkansas Corporation (dissolved), et al.,

Plaintiffs-Appellants,
against

ADAMS & PECK, et al.,

Defendants-Appellees.

On Appeal from the United States District Court For the Southern District of New York

BRIEF OF DEFENDANT-APPELLEE.
AMERICAN STOCK EXCHANGE, INC.

LORD, DAY & LORD Attorneys for Defendant-Appellee American Stock Exchange, Inc. 25 Decadway New York, New York 10004 (212) 344-8480

JOHN J. LOFIAN
R. SCOTT GREATHEAD
Of COUNTY

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IN THE

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Docket No. 74-2588

In re: SEEBURG-COMMONWEALTH

UNITED LITIGATION DOCKET NO. M-19-95

BERRY PETROLEUM COMPANY, an Arkansas Corporation (dissolved), et al.,

Plaintiffs-Appellants,

-against-

ADAMS & PECK, et al.,

Defendants-Appellees,

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF DEFENDANT-APPELLEE AMERICAN STOCK EXCHANGE, INC.

PRELIMINARY STATEMENT

This brief is respectfully submitted on behalf of defendant-appellee American Stock Exchange, Inc. (the

"Amex") in response to the brief submitted by plaintiffsappellants. The plaintiffs' appeal is from a decision
dated August 14, 1974 of the United States District Court
for the Southern District of New York (Hon. Frank H.
McFadden, J. sitting by assignment), which, among other
things, granted defendant Amex's motion pursuant to Rule
12(b) of the Federal Rules of Civil Procedure to dismiss
the complaint for failure to state a claim upon which
relief can be granted. (App. 58-67).*

STATMENT OF THE CASE

The instant action was commenced on December 15, 1972 in the United States District Court for the Northern District of Texas by Berry Petroleum Company ("Berry"), and four former Berry shareholders, suing individually and on behalf of former Berry shareholders as a class, seeking to recover damages allegedly suffered in connection with the sale of all of Berry's assets to Commonwealth

^{*} All citations to "App.--", are to the Joint Appendix filed in this action.

United Corporation ("Commonwealth") in exchange for Commonwealth stock. The cause of action is alleged to arise "under Section 10(b) of the Securities Exchange Act of 1934 [15 U.S.C. §78j(b)] and the rules and regulations of the Securities and Exchange Commission promulgated under said act, state laws and common law principles." (Complaint, ¶15, App. 16).

As stated in the complaint, Commonwealth securities were listed and traded on the Amex until July 22, 1969, when the Amex suspended trading. (Complaint, ¶20, App. 18). Over-the-counter trading in Commonwealth securities continued until August 1, 1969, when the Securities and Exchange Commission ordered that it be suspended. (Id.) Over-the-counter trading in Commonwealth securities resumed on December 23, 1969. (Id.)

In their complaint, plaintiffs allege without specification that the "defendants knew, or should have known," that certain representations by Commonwealth were false and misleading, were material, and that they would be relied upon by the plaintiffs and the officers, directors and stockholders of Berry in connection with the sale of Berry's assets to Commonwealth. (Complaint, 123, App. 23). The complaint further alleges without

specification that "each of defendants approved, authorized, ratified and/or acquiesced in the false and misleading statements complained of and/or otherwise aided and abetted in the implementation of the wrongs complained of herein."

The only specific reference in the complaint to any conduct on the part of the Amex which was allegedly violative of the federal securities laws is contained in \$122(n):

"Defendant American Stock Exchange was negligent in permitting [Commonwealth's] listing applications and permitting the actions and practices of defendants designed to manipulate the market price of Commonwealth securities traded on the American Stock Exchange herein set forth." (App. 22).

The complaint contains no reference to Section 6 of the Securities Exchange Act of 1934, nor does it allege that the Amex failed to enforce any of its own rules or failed to comply with the duties and obligations imposed on a national securities exchange by Section 6 of the Securities Exchange Act.

THE COURT BELOW CORRECTLY HELD THAT THE COMPLAINT FAILS TO STATE A CLAIM AGAINST THE AMEX

On a number of grounds, we submit that the court below correctly held that "the complaint fails to state a claim against [the Amex] upon which relief can be granted." (App. 60).

A. The Complaint Fails to Allege Fraud by the Amex with Sufficient Particularity

apparently including the Amex--had knowledge or should have known of various false and misleading representations by Commonwealth, and that "each of defendants approved, authorized and/or acquiesced in the false and misleading statements herein complained of and/or otherwise aided and abetted in the implementation of the wrongs complained of herein." (¶23, App. 23). However, the complaint contains no specification whatsoever of facts to support this conclusory allegation that the Amex (1) had knowledge or should have known of any fraudulent misrepresentations, (2) performed any act in connection with any fraudulent activity, or (3) otherwise aided and abetted any fraudulent

acts.* In short, the allegations in the complaint of fraudulent conduct on the part of the Amex are a model of vagueness.

Rule 9(b) of the Federal Rules of Civil Procedure requires that "in all averments of fraud ... the circumstances constituting fraud ... shall be stated with particularity." It is settled beyond question that FRCP 9(b) applies to actions brought under Section 10(b) of the Securities Exchange Act. Shemtob v. Shearson, Hammill & Co., 448 F.2d (2d Cir. 1971); Segal v. Gordon, 467 F.2d 602 (2d Cir. 1972). It is equally well settled that "merely conclusory allegations to the effect that defendant's conduct was fraudulent or in violation of Rule 10b-5 are insufficient" to state a claim under Section 10(b). Shemtob v. Shearson, Hammill & Co., supra, 448 F.2d at 444. This Court and other courts have frequently applied FRCP 9(b) to dismiss complaints which contain "mere conclusory allegations to the effect that

^{*} Indeed, the only specific reference in the complaint to any conduct by the defendant Amex is the Exchange's alleged negligence "in permitting [Commonwealth's] listing applications and permitting the actions and practices of defendants designed to manipulate the market price of Commonwealth securities...." (Complaint, ¶22n, App. 22). As discussed under Point B, infra, allegations of negligence are insufficient to state a cause of action under Section 10(b) of the Securities Exchange Act.

defendant's conduct was fraudulent..." Shemtob v.

Shearson, Hammill & Co., supra, at 444. See, Segal v.

Gordon, supra; Kellman v. ICS, Inc., 447 F.2d 1305 (6th

Cir. 1971); Duane v. Altenburg, 297 F.2d 515 (7th Cir.

1962).

Thus, the plaintiffs' conclusory allegations that the Amex directly violated, or aided and abetted any violations of Section 10(b), without any specification of facts to support this claim, fails to state a cause of action for fraud against the Amex. As this Court stated in Segal v. Gordon, supra, "'[m]ere general allegations that there was fraud, corruption or conspiracy or characterizations of acts or conduct in these terms are not enough no matter how frequently repeated.'" 467 F.2d at 607, quoting, Chicago Title & Trust Co. v. Fox Theatres Corp., 182 F.Supp. 18, 31 (S.D.N.Y. 1960).

any facts to support their claims of fraud against the Amex for the simple reason that they know of no facts to support such claims. The plaintiffs themselves have stated as much, by their complaint that "the District Court was premature ... in dismissing appellants' suit without permitting any discovery to discern the facts surrounding the Commonwealth

violations." (Appellants' brief, page 19). However, it is just this sort of pleading which FRCP 9(b) is intended to eliminate. As Judge Metzner recently stated in dismissing a Rule 10b-5 complaint for failure to plead the circumstances of fraud with sufficient particularity,

"... [T]he intent of Rule 9(b) is to eliminate the type of fraud action in which the facts are learned after the complaint is filed. As Judge Moore has pointed out, '[a] complaint alleging fraud should be filed only after a wrong is reasonably believed to have occurred; it should serve to seek redress for a wrong, not to find one.' Segal v. Gordon, 467 F. 2d 602, 607-08 (2d Cir. 1972)." Goldwerg v. Shapiro, [Current Transfer Binder] CCH Fed. Sec. L. Rep. ¶94,813, at 96,717 (S.D.N.Y. 1974).

B. Allegations of Mere Negligence on the Part of the Amex are Insufficient to State a Claim under Section 10(b)

"under Section 10(b) of the Securities Exchange Act of 1934
... and pendant common law concepts." (Appellants' brief,
page 2). As well as vague and conclusory claims of fraud
against the Amex, plaintiffs have alleged without elaboration that the Amex "was negligent in permitting Commonwealth
listing applications and the actions and practices of
Commonwealth designed to manipulate its market price."

(Id., page 18). It is clear, however, that allegations of mere negligence on the part of a defendant are insufficient to state a cause of action for damages under Section 10(b) of the Securities Exchange Act.

As this Court has frequently held, in a private action for damages under Section 10(b), no violation occurs

"' in the absence of allegation of facts amounting to <u>scienter</u>, intent to defraud, reckless disregard for the truth, or knowing use of a device, scheme or artifice to defraud. It is insufficient to allege mere negligence.' [quoting Shemtob v. Shearson, Hammill & Co., supra, 448 F. 2d at 445].

"...[T]he rule-making power granted to the Securities and Exchange Commission by Section 10(b) authorizes rules making it unlawful '[t]o use or employ ... any manipulative or deceptive device or contrivance ...' (emphasis added). These words negate liability for a mere negligent omission or misrepresentation."

Lanza v. Drexel, 479 F.2d 1277, 1304-05 (2d Cir. 1973).

See, Chris-Craft Industries, Inc. v. Piper Aircraft
Corp., 480 F.2d 341, 363 (2d Cir. 1973), cert. denied,
414 U.S. 910, 924 (1974); Cohen v. Franchard Corp.,

478 F.2d 115, 123 (2d Cir. 1973), cert. denied, 414 U.S. 857 (1974).*

Consequently, plaintiffs allegations of negligence on the part of the Amex fail to state a claim for damages under Section 10(b).

C. Allegations of Mere Inaction on the Part of the Amex are Insufficient to State a Claim under Section 10(b)

The essence of plaintiffs' claims against the Amex apparently is that the Exchange "acquiesced in the false and misleading statements herein complained of..."

Plaintiffs citation of the district court's decision in Pettit v. American Stock Exchange, 217 F. Supp. 21 (S.D.N.Y. 1963) (Appellants' brief, pages 18-19), is inapposite and unavailing. The complaint in that action alleged violation by the Amex of Section 6 as well as Section 10(b) of the Securities Exchange Act. The claims against the Exchange were made largely on the basis of facts contained in a deta' ed report by the Securities and Exchange Commission . Aich the court found to be "a severe indictment of the Exchange." 217 F. Supp. at 24. The Pettit Court found that allegations of negligence by the Amex sufficed to state a cause of action against the Exchange under Section 6 of the 1934 Act. 217 F.Supp. at 29-30. In contrast, the instant complaint contains absolutely no allegation that Section 6 of the 1934 Act was violated, nor would the facts alleged in the complaint support such an allegation. Moreover, since trading in Commonwealth securities was suspended by the Amex on July 22, 1969 (complaint ¶ 20, App. 18) and this action was not commenced until December 15, 1972, any claims against the Amex for negligence are unquestionably barred by the twoyear statute of limitations contained in Article 5526 of the Texas Revised Civil Statutes.

(Complaint ¶23, App. 23). The complaint contains no allegation that the Amex made any representations or took any other affirmative action in connection with any fraudulent scheme. In short, the complaint alleges only mere inaction on the part of the Amex and therefore fails to state a claim under §10(b) of the Securities Act of 1934.

In Lanza v. Drexel & Co., supra, this Court, adopting language from Wessel v. Buhler, 437 F.2d 279 (9th Cir. 1971), stated:

"We find nothing in Rule 10(b)(5) that purports to impose liability on anyone whose conduct consists solely of inaction. On the contrary, the only subsection that has any reference to an omission, as distinguished from affirmative action, is subsection (2) providing that it is unlawful 'to omit to state a material fact necessary in order to make the statements made ... not misleading' i.e., an omission occurring as part of an affirmative statement.... We perceive no reason, consonant with the congressional purpose in enacting the Securities and Exchange Act of 1934, thus to expand Rule 10b-5 liability.... On the contrary, the exposure of independent accountants and others to such vistas of liability, limited only by the ingenuity of investors and their counsel would lead to serious mischief." 479 F.2d at 1300.

The lack of any authority suggesting that liability under Section 10(b) of the 1934 Act extends to anyone whose conduct consists solely of inaction was recently noted by the Seventh Circuit in its decision in Hochfelder v.

Midwest Stock Exchange, 350 F.2d 1122 (N.D. III. 1972), aff'd

503 F.2d 364 (7th Cir.), cert. denied, 43 U.S.L.W. 3203 (October 15, 1974), an action dismissing a complaint charging a securities exchange with violations of Section 10(b) and Section 6 of the 1934 Act:

"Confronting the charge of aiding and abetting solely by inaction we note that it is well established that one may aid and abet by inaction in combination with affirmative action. See, Brennan v. Midwestern United Life Insurance Co., 417 F.2d 147 (7th Cir. 1969), cert. denied, 397 U.S. 989 (1970); Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 410 F.2d 135 (7th Cir. 1969), cert. denied, 395 U.S. 838 (1969). However, in those cases where we have stated that one may aid and abet solely by inaction, we reached a finding of liability on the basis of affirmative action in combination with inaction. See, e.g., Brennan v. Midwestern Life Ins. Co., 259 F. Supp. 673 (N.D. Ind. (1966); Anderson v. Francis I. DuPont & Co., 291 F. Supp. 705 (D. Minn. 1968). Indeed, in the only case where it may fairly be stated that the court was faced with a claim of aiding and abetting solely by inaction, the Ninth Circuit declined to accept such a theory of Rule 10b-5 liability.... [Citing Wessell v. Buhler, supra]." F. 2d at 374.

Since the allegations contained in the complaint charge the Amex solely with inaction, the plaintiffs have failed to state a cause of action against the Amex for a violation of Section 10(b) of the 1934 Act.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the decision of the court below dismissing the complaint against the Amex should be affirmed.

Dated: March 7, 1975

Respectfully submitted,

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UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Index No. 74-2588

BERRY PETROLEUM CO.

Plaintiff

AFFIDAVIT OF SERVICE BY MAIL

Adams & Peck

Defendant

STATE OF NEW YORK, COUNTY OF NEW YORK

against

SS.:

The undersigned being duly sworn, deposes and says:

Deponent is not a party to the action, is over 18 years of age and resides at 24-84 Fir Court East Meadow, New York 11554

That on March 7 BRIET

19 75, deponent served the annexed

on see annexed service list attorney(s) for

in this action at the address designated by said attorney(s) for that purpose by depositing a true copy of same enclosed in a postpaid properly addressed wrapper, in-a post office-official depository under the exclusive care and custody of the United States Postal Service within the State of New York.

Sworn to before me

March 7, 1975

NOTARY PUBLIC, State of New York No. 24 54 13550

Qualified in Kings County Certificate filed in New York County Commission Expires March 30, 197

Index No.

Plaintiff

against

ATTORNEY'S AFFIRMATION OF SERVICE BY MAIL

Defendant

STATE OF NEW YORK, COUNTY OF

SS.:

The undersigned, attorney at law of the State of New York affirms: that deponent is attorney(s) of record for

That on

19 deponent served the annexed

on attorney(s) for in this action at

the address designated by said attorney(s) for that purpose by depositing a true copy of same enclosed in a postpaid properly addressed wrapper, in—a post office—official depository under the exclusive care and custody of the United States Postal Service within the State of New York.

The undersigned affirms the foregoing statement to be true under the penalties of perjury.

Dated

The name signed must be printed beneath

Attorney at Law